



California Economic Forecast
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From: Mark Schniepp

RE: Economic state of the State and the Outlook

I have attached some commentary and charts on the recent evidence and the economic outlook for California and its principal regions.

Our forecasts are derived from our econometric models of California and the various regions within the state.

We can provide a more comprehensive report detailing the recent evidence and forecasts of employment, income, housing, and sales by region in California at a later date.

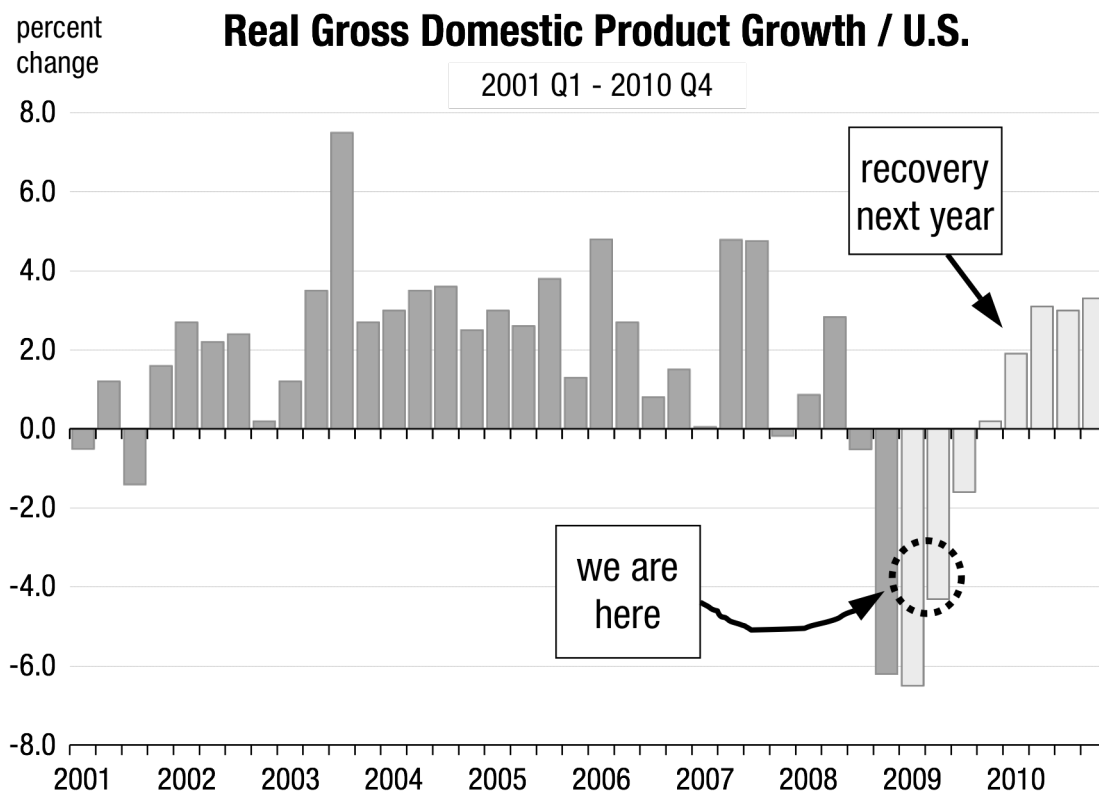
Our next Forecast Conference is in San Diego County with the UCLA Anderson Forecast on May 15, 2009. We also present forecast conferences in Orange County, the Santa Clarita Valley, the Antelope Valley, Santa Barbara County, Ventura County, and San Luis Obispo County.

The U.S. Economy

For the first 8 months of 2008, it was unclear just how much contraction in the economy was occurring because many sectors were still growing and GDP growth remained positive. The events of September and October of 2008 left the U.S. financial system in disarray.

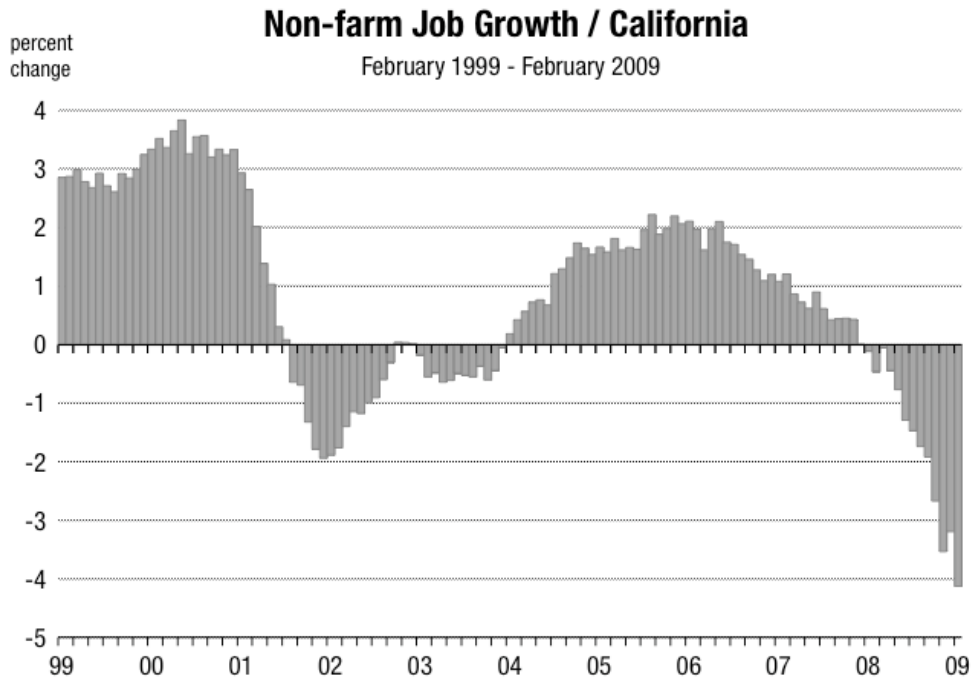
The massive government intervention to prevent a freeze up of the system changed the landscape dramatically. By November, Fannie Mae and Freddie Mac were in government receiverships, AIG was a ward, the Federal Reserve was the lender of last resort in the Commercial Paper market and the Treasury was an investor and part owner of banks across the nation. All of the major stock market indexes went into freefall. The Dow Jones Industrial Average ended calendar year 2008 with a net loss of 35 percent, the third largest one year decline on record.

GDP contracted at a 6.2 percent pace in the October-December 2008 quarter, validating the onset of a severe economic recession which was announced on December 1 to have started in January 2008. The first quarter 2009 report will be equally as grim. The consensus of economists believes the recession will last through the third quarter of 2009, with some positive growth in GDP by the fourth quarter. However, a more convincing recovery is predicted for mid-2010.



Forecast Summary for California

The downward momentum of the economy---in both the U.S. and California--as of March 2009 remains swift. Jobs losses are occurring at an unprecedented rate of decline. The unemployment rate has climbed to 10.9 percent in California.



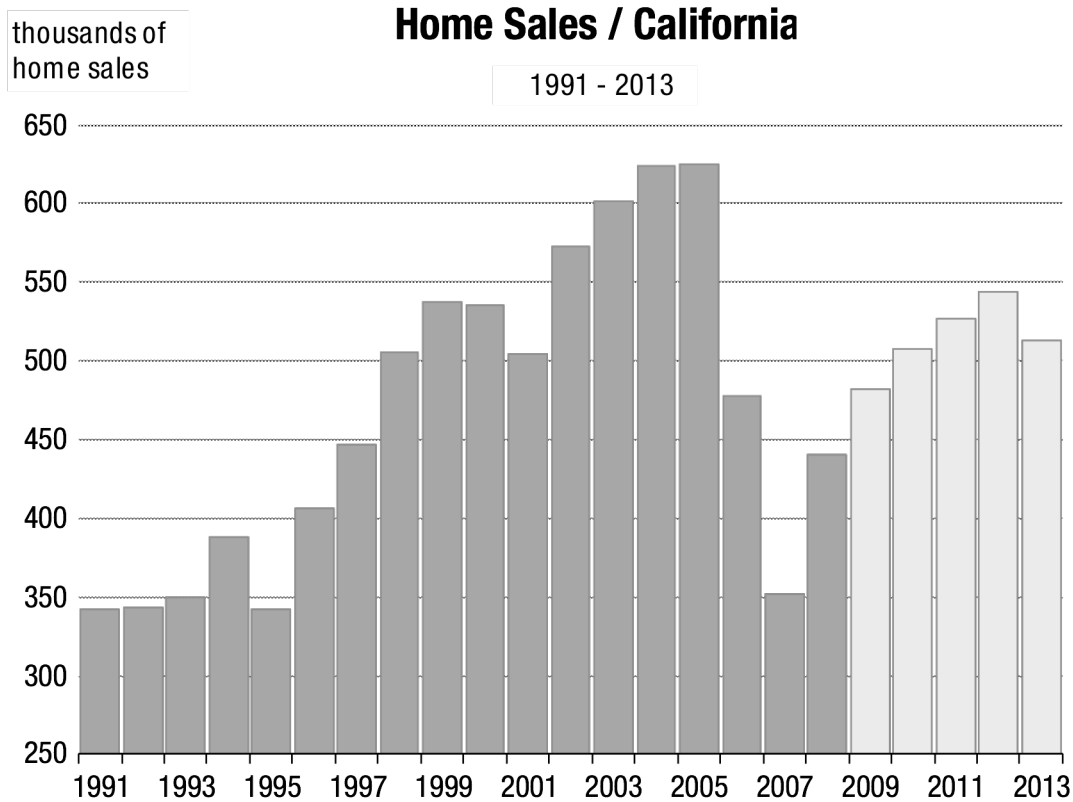
Federal government intervention that reduces the labor market collapse and creates new spending in the economy should help to break the current freefall. The Homeowner Affordability and Stability Act should positively affect the mortgage industry and lower mortgage rates would produce needed growth in conventional home sales and stability in selling values. We believe this will ultimately occur and lead to a general economic recovery--though tepid--sometime in the second half of the year.

The U.S. economy remains in recession through mid-summer of this year, and probably through September and into October. Growth returns in the 4th quarter of 2009 though you might not notice much progress at that time.

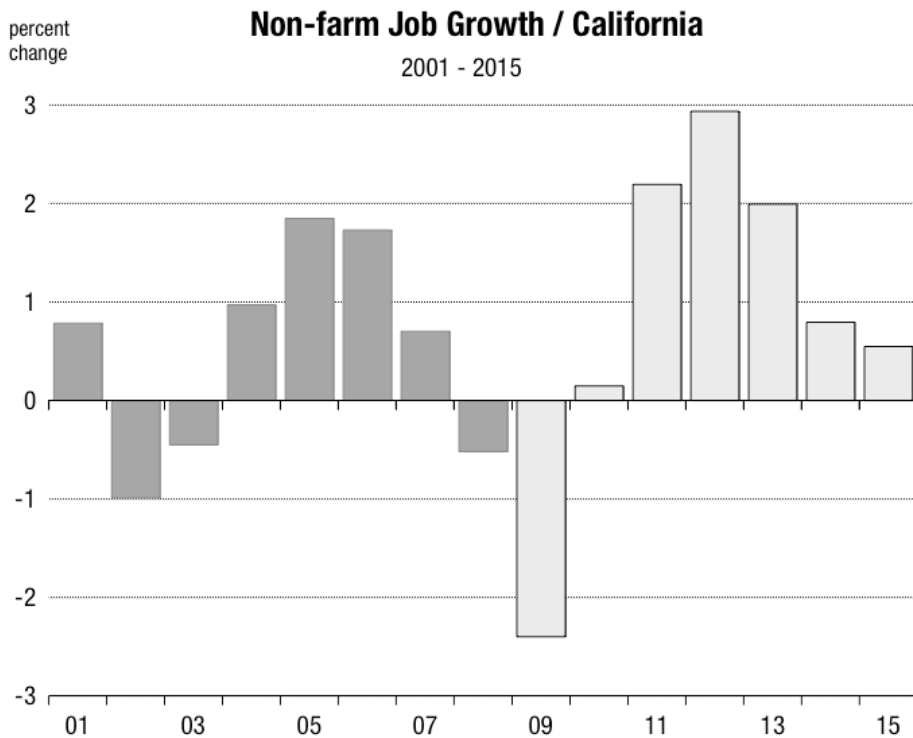
The economic environment in California will remain in recession for most of 2009. What will be noticeable is a rebound in conventional home sales, rather than distressed home sales that are occurring now. Furthermore, home prices will stabilize by summer and that may enable real estate related industries to begin to hire again.

The 2009 forecast does include a rebound in residential construction, with steadily improving demand for homes in 2010 and 2011. The recovery of new home production follows on the heels of a clear recovery in existing home sales, by mid-year. However, through at least the first

half of 2009, the economic recession will translate into a general idleness of workers, equipment, and industrial and office capacity.



Cost-cutting concerns will remain a key focus of firms, even as the economy begins to stabilize later this year. Consequently, labor markets will continue to contract, in the professional services, government, and the financial sector. This will slacken the demand for office space in both the north and south counties. Office building vacancies are forecast to increase through most of the year.



The general outlook for the California economy has job growth accelerating after 2010 and more housing construction after 2009. Home sales rebound sharply this year, on the strength of gradually improving real estate sentiment, principally during the 2nd half of 2009.

The bay area outperforms most areas of the state. The problem areas remain Orange County, the Inland Empire, the Central Valley and the Sacramento Valley.

The California budget crisis will impact public sector employment in the 2nd half of 2009. Financial sector employment will be stabilizing at that time. Professional services employment continues to decline through 2009 and into 2010. Construction employment rises in 2010 as more new housing is started.

The coastal economies of California will weather the current downturn better than inland California. This is due in large part to the diversity of these economies that include large health and education sectors, larger visitor-serving infrastructure, the presence of technology industries, and the absence of large construction or manufacturing sectors which currently are contracting the most.

Forecast Risks

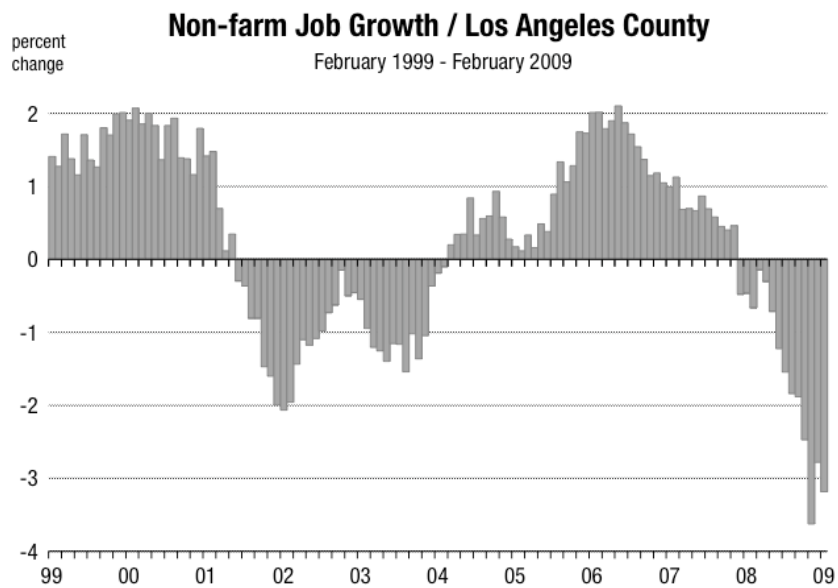
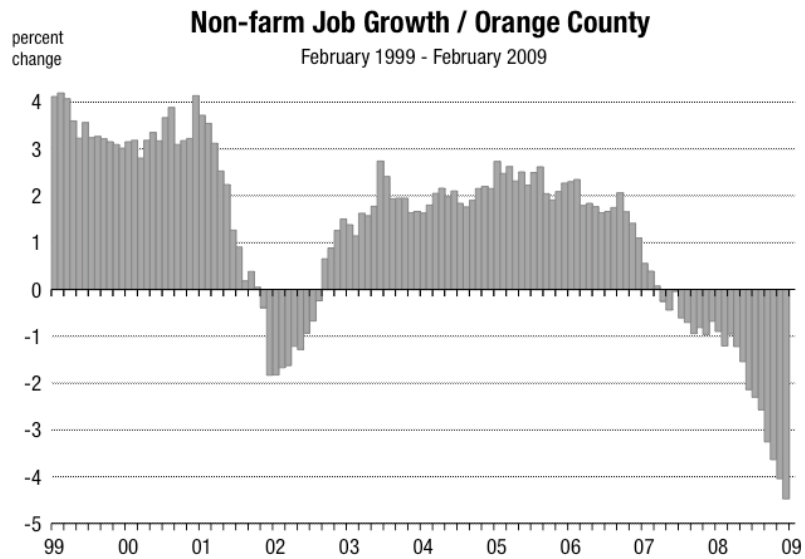
The risks to the forecast of a housing market rebound in the 2nd or 3rd quarters of 2009, and a more general economic rebound starting in the 4th quarter and continuing into 2010 include:

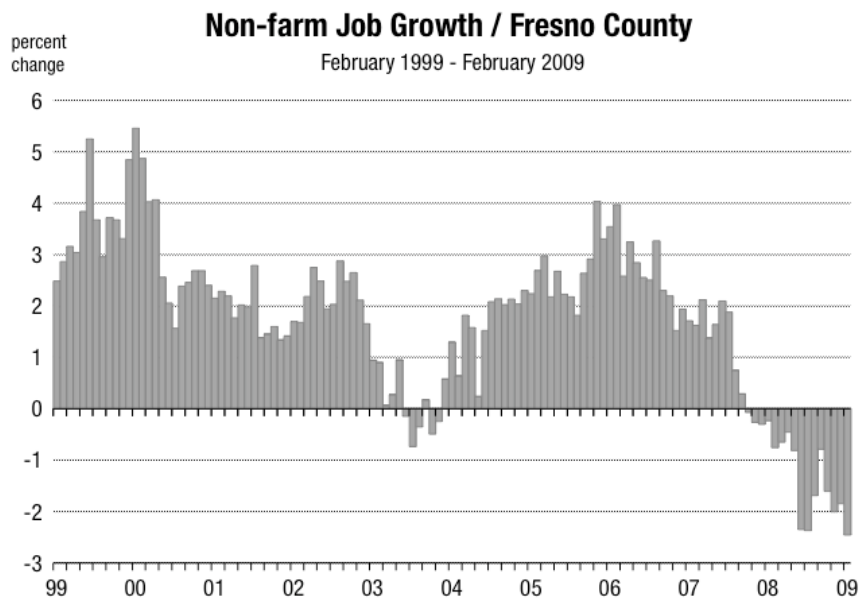
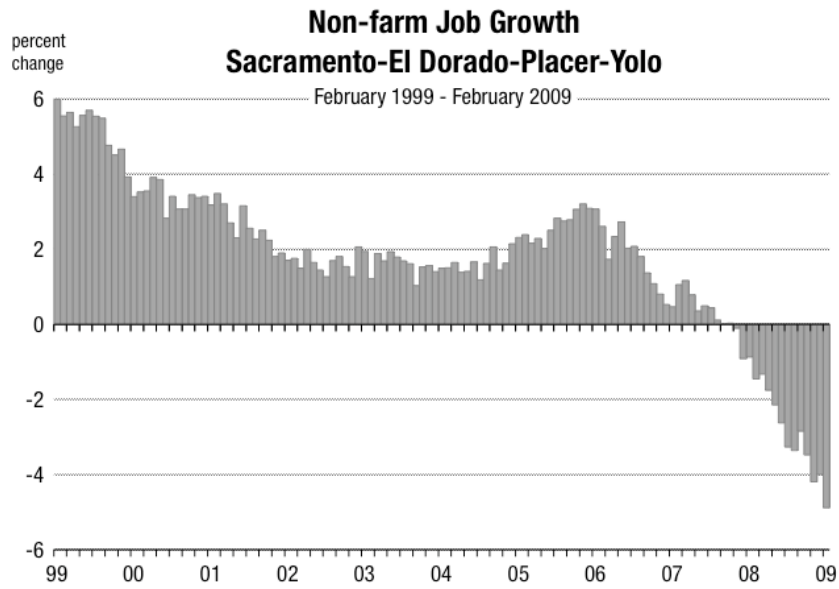
- The credit market thaw is slow. Federal financial sector bailout programs, including the 2nd phase of TARP, fail to produce meaningful lending activity in the nation's banking system. Mortgage rates and other lending rates remain high. Business and consumer investment opportunities are adversely impacted due to the unavailability and unaffordability of loans to finance day-to-day operations, car loans, student loans, and the refinancing of commercial buildings.
- The slowness of the credit market thaw exacerbates an already fragile economic environment globally. The decline in demand for American goods abroad causes export businesses to contract, producing additional layoffs and excess capacity.
- The economy produces greater than expected job loss because both bailout and stimulus programs prove to be ineffective over the next few months. This would lead directly to additional homeowner distress due to the loss of income and the inability to make mortgage payments.
- More homeowner distress would spark a new round of defaults and ultimately foreclosures which would postpone the rebound in housing and the stabilization of selling values.
- The rebound in housing is delayed until labor markets stabilize, the credit crisis clearly shows signs of loosening up, and homeowner distress is clearly in decline again.

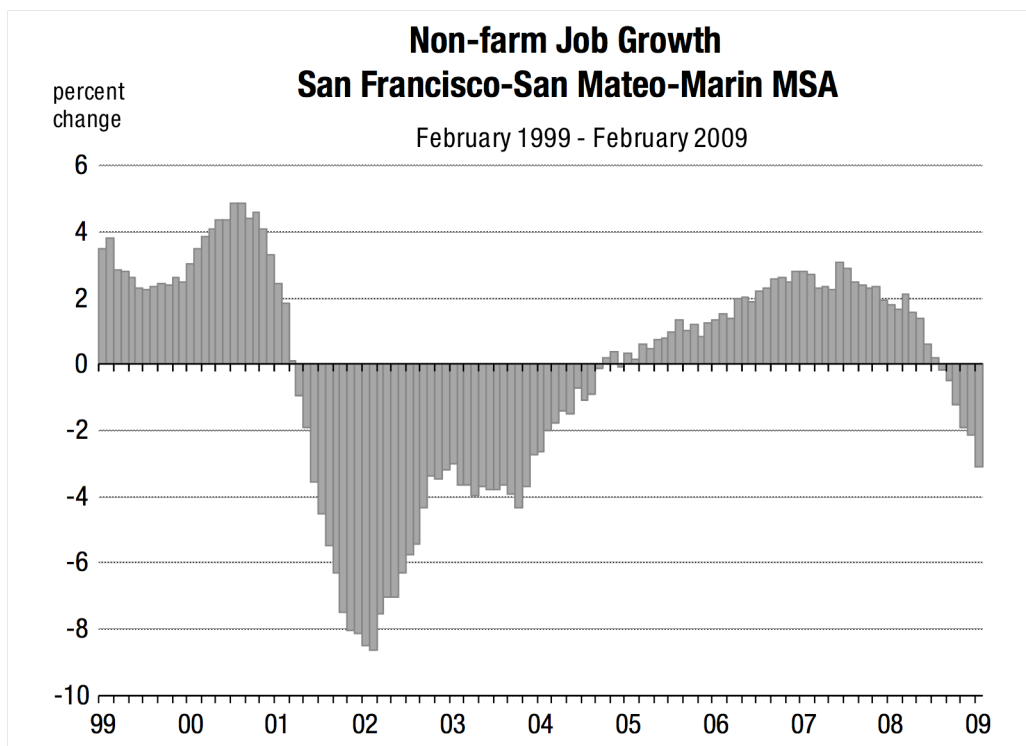
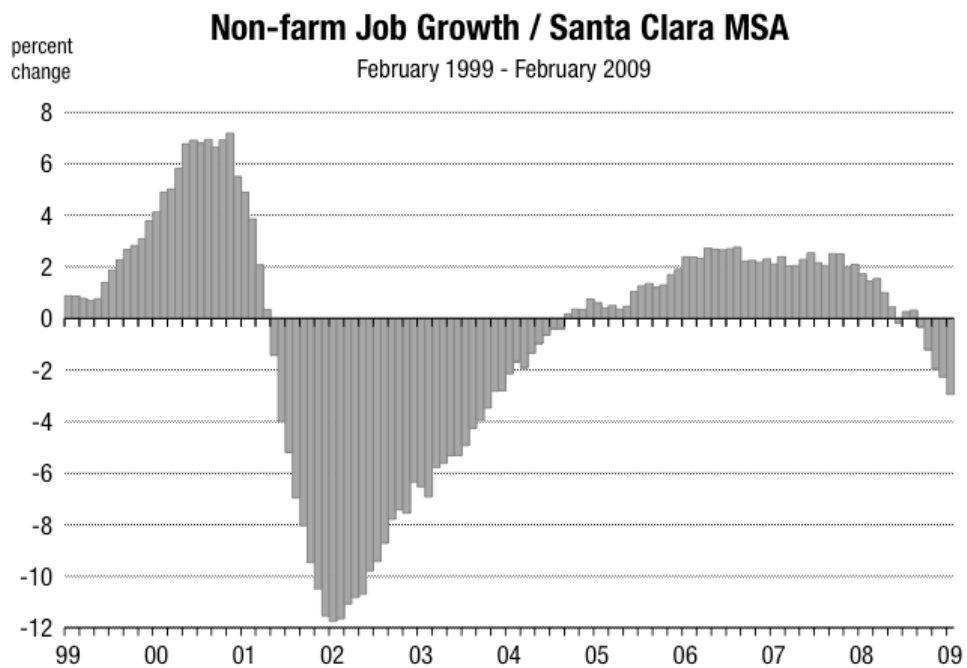
Recently, we have observed greater than expected contraction of the finance, construction, and manufacturing sectors. The retail sector is reeling from the sharp pullback of consumption by households. While the nation is currently in a recession with the rate of unemployment now at 8.1 percent and climbing, a severe contraction could extend beyond the third quarter of this year, especially if housing relapses. Otherwise, the consensus of forecasts has the economy growing in the 4th quarter.

The new Administration's economic stimulus plan to increase spending in the economy should do more to improve the psychology of the country than stimulus. And ultimately, the massive bailouts of the nation's banks will help to unclog the credit markets and promote more lending.

Recent Evidence for the Regions of California

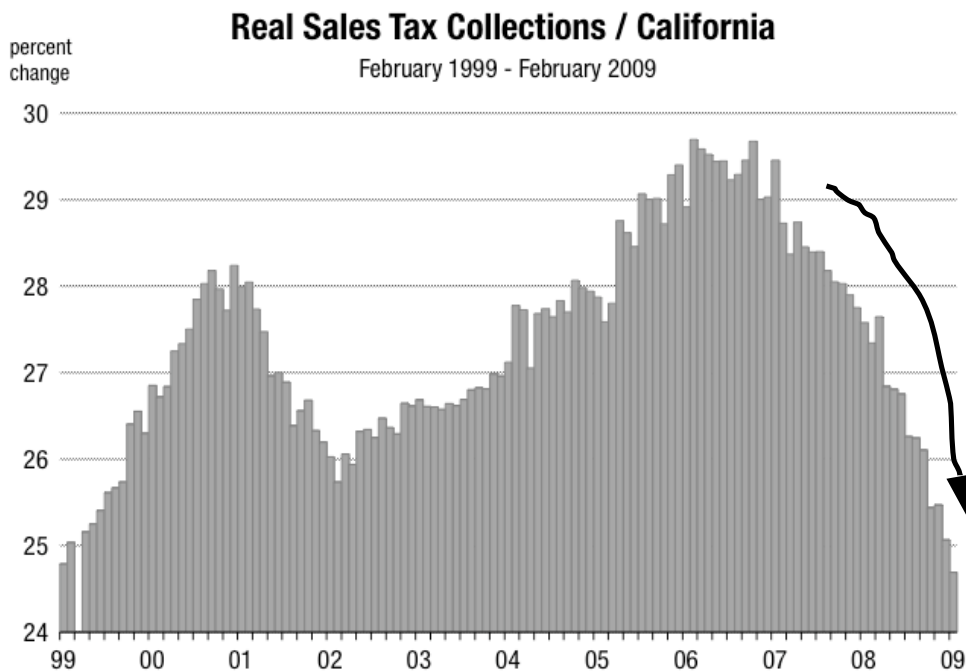






The epi-centers of job loss this year will be Orange County, LA County, the Inland Empire, and the Sacramento Valley. Regional economies where construction and manufacturing are a significant portion of the jobs base will suffer the most. In the case of Orange County, the principal job loss is associated with mortgage activity.

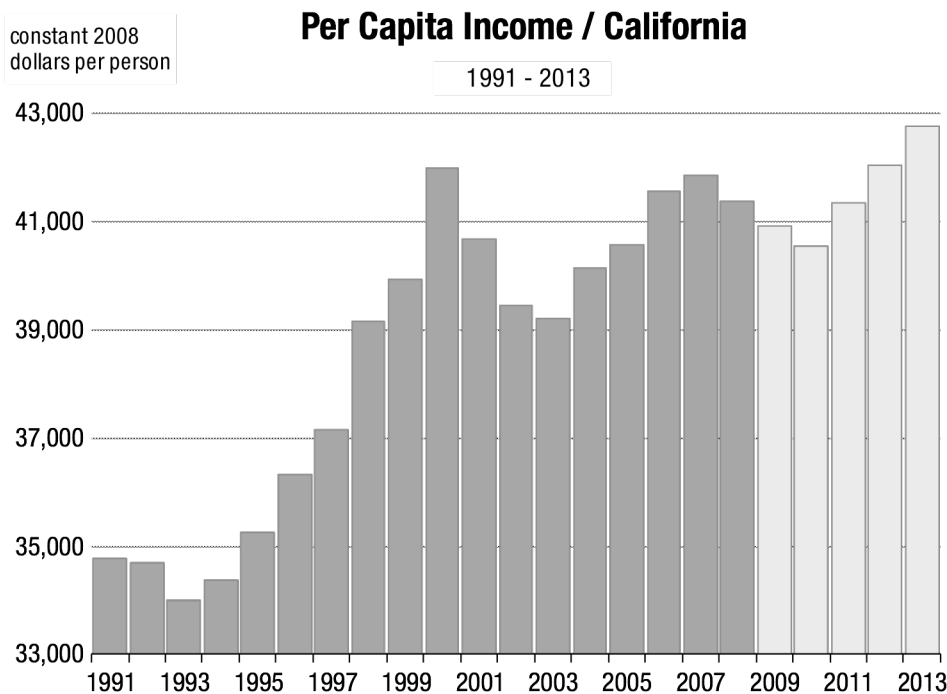
The declines in income and the financial panic that gripped the nation including California has resulted in a sharp pullback by consumers. The corresponding affect on retail goods and services spending was abrupt. Bankruptcies in the retail sector have been prolific. Retail store vacancy rates have soared. Sales tax receipts to the state are currently in a freefall, exacerbating the and this has brought a new level of attention to the budget problems in California.



The stock market is now stabilizing, having attained its low for the cycle on March 9, 2009. The heightened anxiety by consumers has already begun to moderate. Housing prices will begin to stabilize along the coast and inland areas of California between the summer of 2009 and early 2010. The horrific job reports will begin to fade this spring in the national economy. The credit market thaw will become more convincing as 2009 progresses and the panic that has gripped the national economy since last September will abate.

Less anxiety over the direction of the economy will enable consumers to spend again, albeit with less wealth and zeal this year and next.

Job growth will rebound sharply in the inland counties of California, beginning next year. Because the inventory overhang of unsold housing has been eliminated, as foreclosures decline and prices stabilize, building will begin again and the construction industry will be creating jobs in 2010.



Per capita income adjusted for inflation declines this year and next before rebounding in 2011 as more new jobs are created and the expansion gains strength.

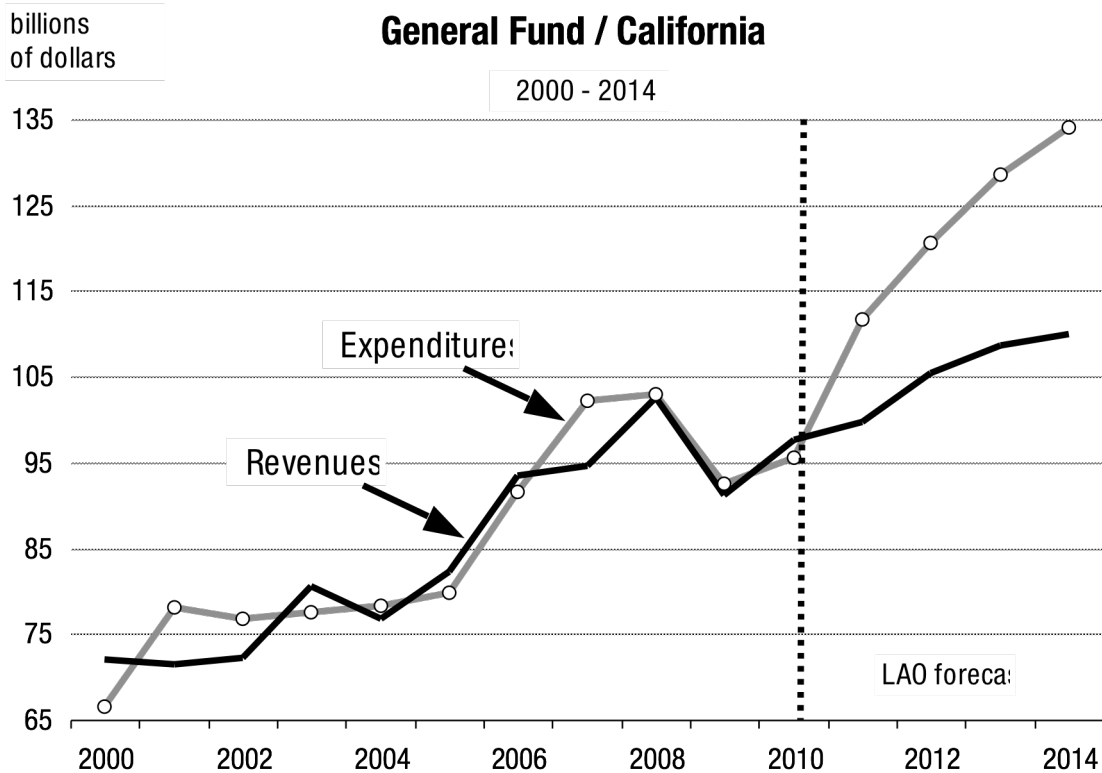
General Fund Forecast

The Legislative Analyst's Office forecasts continued trauma in the California budget over the next five years. Though revenues grow, expenditures will grow by a greater amount, potentially creating another \$20 billion deficit by 2013-14.

Revenue growth lags expenditure growth due to a slowly recovery to personal income receipts and consumer spending, namely retail sales and the taxes they bring. The outlook for personal income and retail sales remains muted through 2009 and 2010, reversing in 2011. However, in 2011, the higher sales tax rate sunsets as do current spending constraints. This scenario without any further intervention (action) by the legislature, will produce growing deficits that will require new financing approaches.

As births in the state increase and job opportunities that bring accelerated levels of new migrants, more dollars for K-12 schools will be needed, along with healthcare and social services.

Unless a major overhaul of the budgetary process is performed in Sacramento, the outlook for state finances is grim, and California will face higher costs to borrow for the indefinite future.



There are annual operating shortfalls under the LAO March Forecast

Foreclosures

Foreclosures are beginning to abate throughout California, which is good news for the housing sector. Foreclosures peaked during the third quarter of 2008 and fell sharply in the fourth quarter.

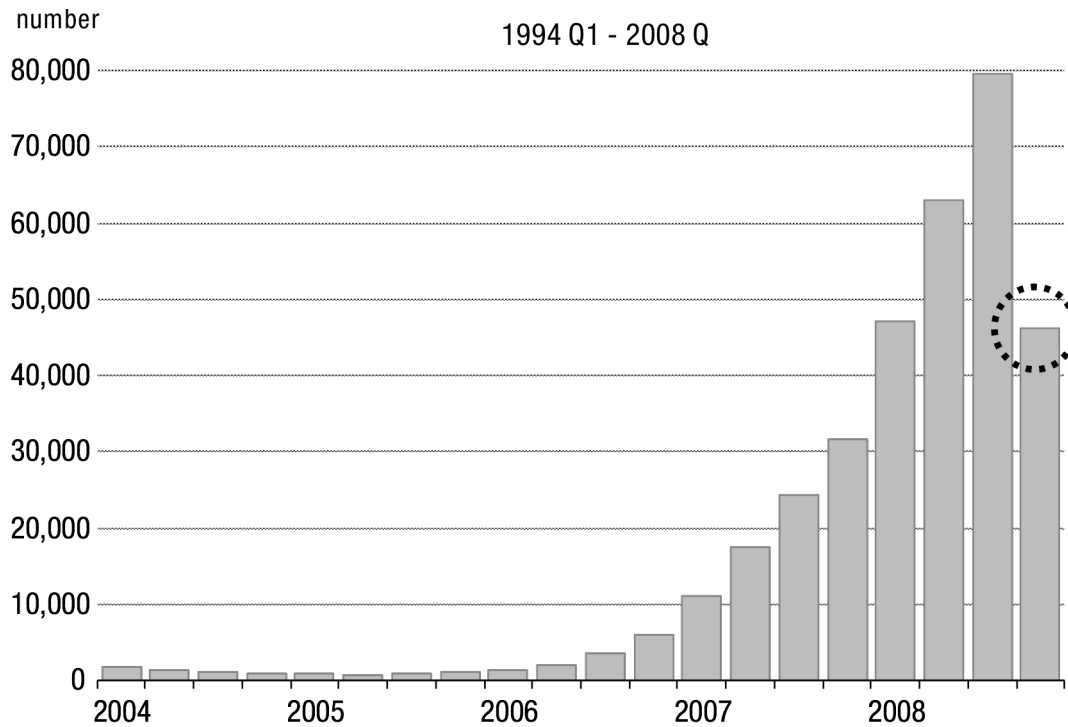
While early evidence suggests that notices of default have rebounded in the first quarter of 2009, the extent of the upturn is limited.

The March rates of foreclosure by County have now sunk to the lowest levels since the early Summer of 2008. The turnaround will begin to have stability on home prices in the state, especially in the coastal markets and the Bay Area.

We believe that home prices will stabilize by late Spring and/or early Summer, and that a more conventional rebound in home sales will ensue.

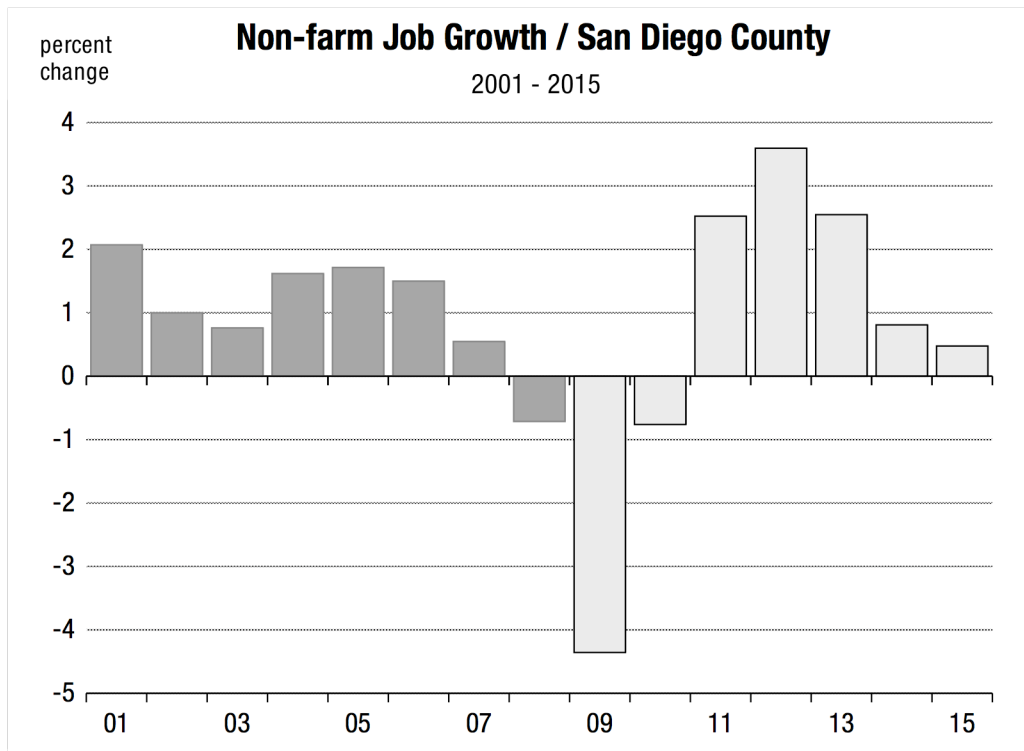
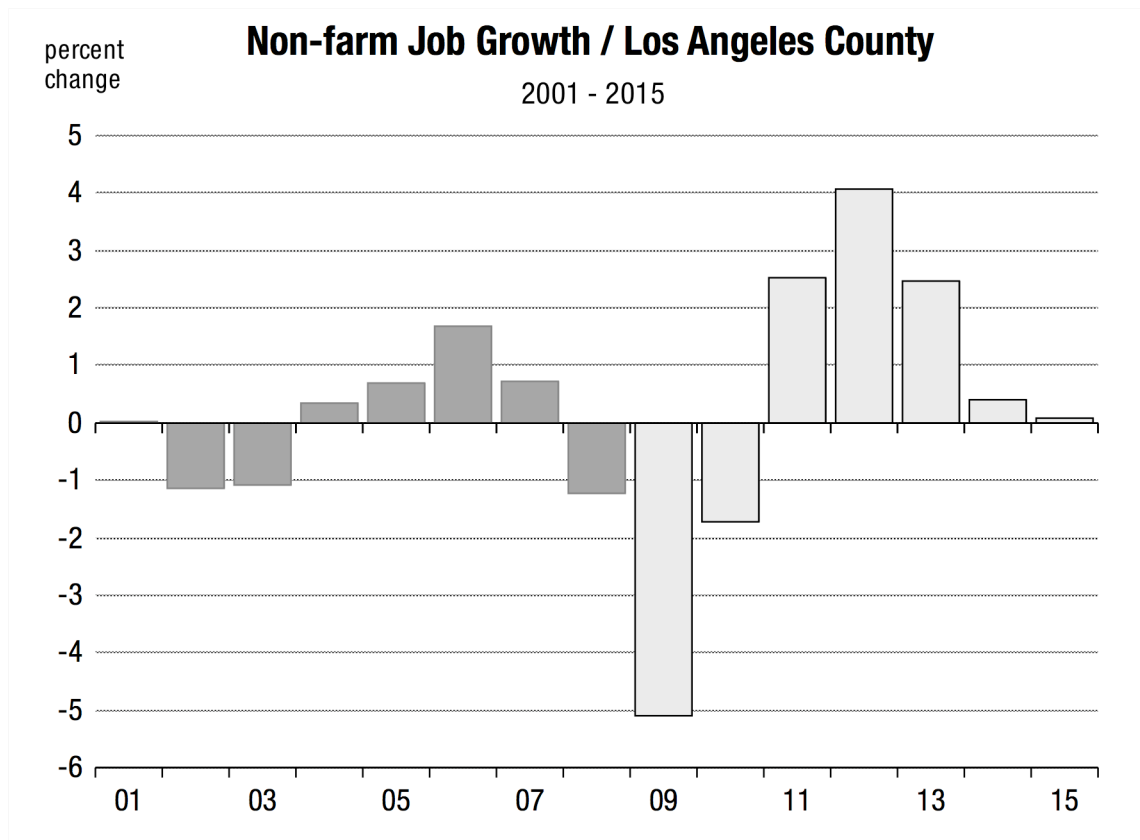
Home prices will begin rising in the coastal counties before the inland counties of California, though the increase in prices will not be pronounced.

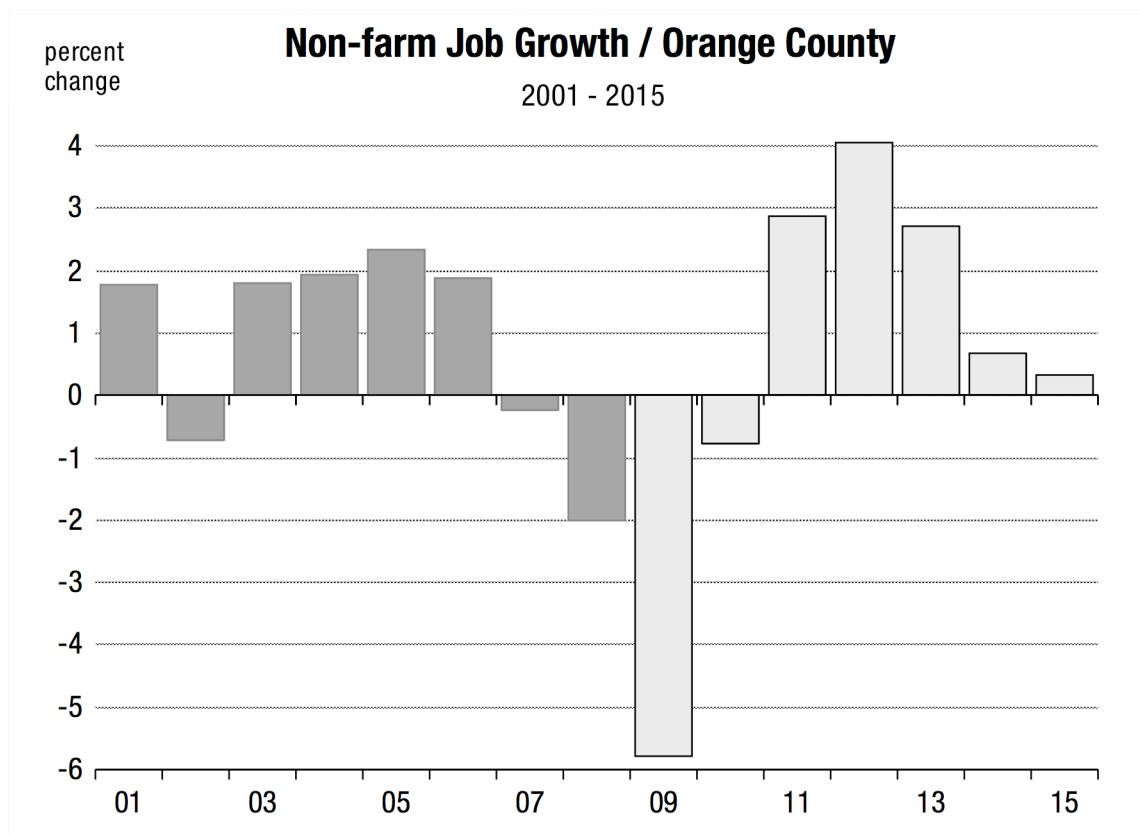
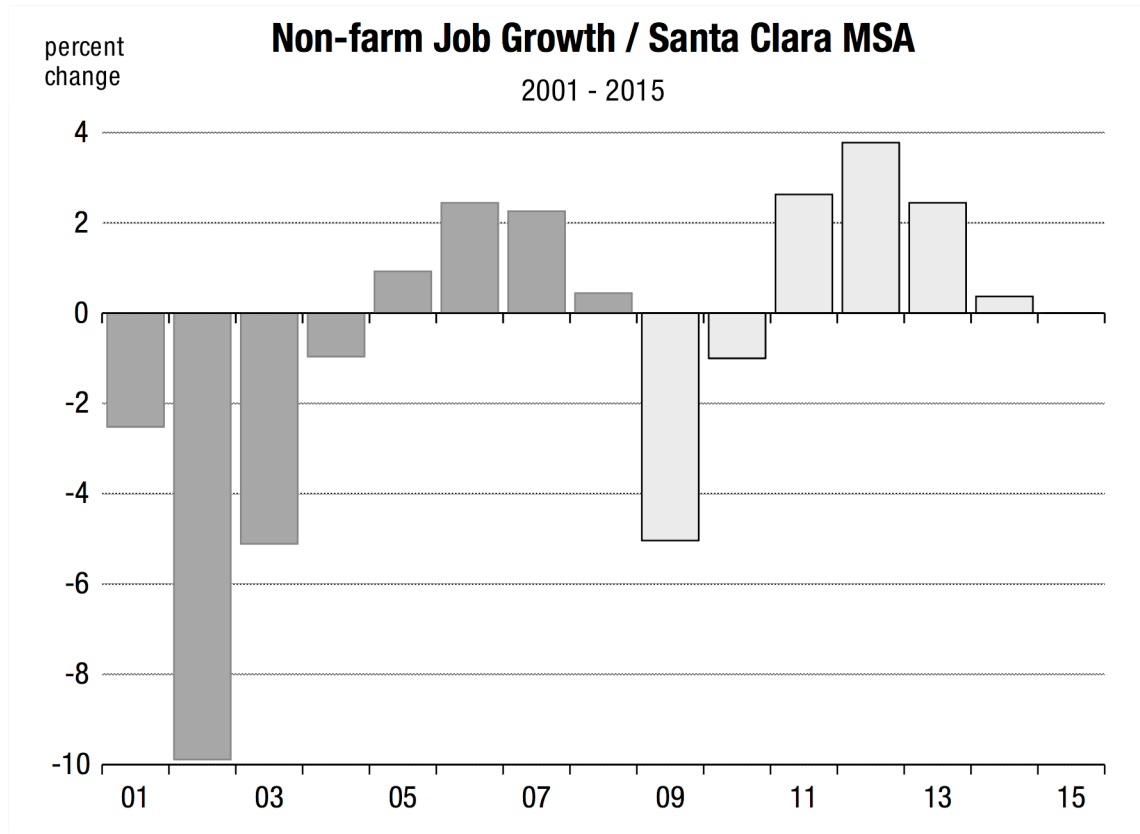
Foreclosures / California



Rate of Foreclosures per 1,000 Homes					
Region	August 2008	October 2008	December 2008	February 2009	March 2009
Orange County	5.6	6.7	6.5	5.6	4.3
Los Angeles County	5.9	7.2	7.1	6.4	5.3
Sacramento County	15.5	18.3	17.4	16.4	13.1
Fresno County	9.1	11.2	11.2	10.7	8.8
Santa Clara County	4.6	6.1	6.4	6.2	5.3

The Forecast for Employment by principal region





Preparers

The California Economic Forecast

www.californiaforecast.com

The California Economic Forecast is an economic consulting firm engaged in research and consulting support for business and public sector clients. The firm's experience includes economic analysis and forecasting for business, non-profits, cities, regional organizations, colleges and universities.

Dr. Mark Schniepp is the principal of the firm. Long associated with the UCSB Economic Forecast as the Director and Chief Economist, he is well known in California for his economic and forecasting analysis and commentary on regions of California.

Dr. Schniepp has served as the Senior Economic for the California State Controller's Office and is a consulting economist to the California Department of Transportation, and to the UCLA Anderson Forecast.

California Economic Forecast annually prepares a 58 county economic forecast for the California Department of Transportation and a 25 county economic forecast for Kaiser Permanente. The firm also develops real estate and economic forecasts for counties and sub-county regions that are regularly presented at public conferences throughout the year, including the Orange County Economic Outlook, produced with the UCLA Anderson Forecast, and the Ventura, and Northern Los Angeles Economic Outlook conferences sponsored by First American Title Company.

The firm has completed recent consulting projects for a variety of organizations, such as ExxonMobil, The Irvine Company, The California Association of Realtors, Shea Homes, Cal State Northridge, and The Southern California Association of Governments.

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